

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 99-0217
Adjusted Gross Income Tax
For The Tax Periods: 1993, 1994, 1995**

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ISSUES

I. Adjusted Gross Income Tax – Business/Non-Business Income

Authority: 45 IAC 3.1-1-153, *Mobil Oil Corp. v. Com'r of Taxes of Vermont*, 445 U.S. 425, 437 (1980), *Allied Signal, Inc. v. Director Division of Taxation*, 112 S. Ct. 2251 (1992), *ASARCO, Inc. v. Idaho State Tax Com'n*, 458 U.S. 307 (1982), *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 179 (1983).

The Taxpayer protests the assessment of gross income tax on lease and interest income.

STATEMENT OF FACTS

Taxpayer markets and supplies a variety of products including automotive sound equipment, cellular telephones, automotive accessories and consumer electronics. Taxpayer and Company C, who is a seller of Taxpayer's auto accessories, both have a 49.5% limited partner interest in Company A, which is a distributor to specialized markets for recreational vehicles, van conversions, television and other automotive sound, security and accessory products. Taxpayer and Company C each maintain a 50% general partnership in Company B which has a 1% general partnership interest in Company A. More facts will be supplied as necessary.

I. Adjusted Gross Income Tax:

DISCUSSION

Taxpayer claims a unitary relationship with Company A. During the audit, the auditor determined that Taxpayer and Company A were not in fact engaged in a unitary business and therefore assessed adjusted gross income tax on the income derived from the non-unitary partnership pursuant to 45 IAC 3.1-1-153(c). Taxpayer protests these assessments.

"[T]he linchpin of apportionability in the field of state income taxation is the unitary-business principle." *Mobil Oil Corp. v. Com'r of Taxes of Vermont*, 445 U.S. 425, 437 (1980). A state may tax an apportioned amount of a corporation's multistate business if the business is unitary. *Allied Signal, Inc. v. Director Division of Taxation*, 112 S. Ct. 2251 (1992); *ASARCO, Inc. v. Idaho State Tax Com'n*, 458 U.S. 307 (1982). A state may not tax a nondomiciliary corporation's multistate income if the income is derived from an unrelated business income. *Mobil*, 445 U.S. at 436 (1980).

The Supreme Court has applied a three-part analysis when determining whether the intrastate and out-of-state activities form a part of a single unitary business. The factors include: functional integration, economies of scale, and centralization of management. *Allied Signal* at 2264. In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 179 (1983), the Supreme Court found that these elements may be shown by transactions not undertaken at arms length, a management role by the parent which is provided in the owner's operational expertise and strategy, and the fact that the corporations are engaged in the same line of business.

The audit report points out that there is not a substantial flow of goods and services between the two companies – *i.e.*, between Taxpayer and the partnership. The report also stated that internal services such as financing, accounting and legal services were insufficient to create a unitary relationship. The Department notes, however, that “[t]he prerequisite to a constitutionally acceptable finding of unitary business is a flow of value, not a flow of goods.” *Id.* at 178.

The audit report also notes that there is no centralization of management in that the Taxpayer has 49.5%, non-controlling ownership percentage in Company A. Nevertheless, Taxpayer and Company C wholly own Company B who has the 1% general partnership interest in Company A. The remaining 99% of Company A is owned by Taxpayer and Company C equally as a limited partnership interest. Taxpayer and Company C each provide two officers to Company B. Consequently, both Taxpayer and Company C equally split control of Company A.

When Taxpayer and Company C created Company A, Taxpayer contributed cash, the rights to its trade name, customers, rights to distribute its products and business experience. Company C contributed most of the operations. Taxpayer aides the partnership by guaranteeing the partnership line of credit, by including Company A on its insurance policies, and by handling the partnership customs audit. Taxpayer provides training and gives advice on marketing strategies. Additionally, the officers and employees of Taxpayer and Company A meet to discuss business strategy.

Taxpayer and Company A are in the same line of business. The two companies share a common trade name. From supply and marketing to distribution and sales, Taxpayer and Company A are functionally integrated. Taxpayer markets and supplies a variety of products including automotive sound equipment, cellular telephones, automotive accessories, and consumer electronics. Company A (the partnership) distributes these products through a variety of specialized markets. Taxpayer makes sales to the partnership and the partnership orders all of its goods through Taxpayer's buying office. Consequently, a substantial flow of value exists between Taxpayer and the partnership. From all these facts, the Department finds that Taxpayer has adequately demonstrated the existence of the unitary prerequisites; that is, centralized management, economies of scale, and functional integration.

Taxpayer and Company A engaged in a unitary business. As such, the computation of Taxpayer's business income attributable to Indiana should follow the prescriptions of 45 IAC 3.1-1-153(b). It states:

If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll,

and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year....

Based on all the facts provided, Taxpayer's protest is sustained.

FINDING

Taxpayer's protest is sustained.